

REPORT OF EXAMINATION

Dental Health Services, Inc.

Seattle, Washington

As of December 31, 2002



**Participating State:
Washington**

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify that the attached Report of the Financial Examination of Dental Health Services, Inc., of Seattle, Washington, shows the financial condition and related corporate matters as of December 31, 2002.

A handwritten signature in black ink, appearing to read "Patrick H. McNaughton", written over a horizontal line.

PATRICK H. McNAUGHTON
Chief Examiner

May 26, 2004
Date

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SALUTATION

Seattle, Washington
May 26, 2004

The Honorable Mike Kreidler, Commissioner
Washington State Office of Insurance Commissioner
Insurance 5000 Building
5000 Capital Blvd.
Tumwater, WA 98501

Dear Commissioner Kreidler:

In accordance with your instructions and in compliance with the statutory requirements of RCW 48.03.010, an examination was made of the corporate affairs and financial records of

Dental Health Services, Inc.
of
Seattle, Washington

hereinafter referred to as "DHS" or the "Company," at the location of its home office, 936 N. 34th Street, Suite 208, Seattle, WA 98103. This report is respectfully submitted showing the condition of the Company as of December 31, 2002.

SCOPE OF EXAMINATION

This examination covers the period January 1, 1998 through December 31, 2002 and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements contained in the Washington Administrative Code (WAC), Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook. The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination. The findings of the previous examination report were reviewed and any items that were not satisfactorily addressed by the Company are discussed later in the report.

Corporate records along with various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Company's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

INSTRUCTIONS

The examination team reviewed the Company's filed 2002 NAIC Annual Statement as part of the statutory examination. The review focused on determining if the Company's NAIC Annual Statement was completed in accordance with the NAIC Annual Statement Instructions and if the accounts and records were prepared and maintained in accordance with Title 48 of the Revised Code of Washington (RCW), Title 284 of the Washington Administrative Code (WAC), and NAIC Accounting Practices and Procedures Manual.

The following summarizes the exceptions noted while performing this review:

1. NAIC ANNUAL STATEMENT ERRORS AND MISCLASSIFICATIONS

Our examination of the Company discovered several areas in which the Company's filing of the Annual Statement did not conform to the Accounting Practices and Procedures Manual as adopted by the National Association of Insurance Commissioners (NAIC) and the NAIC Annual Statement Instructions.

The Company is instructed, pursuant to RCW 48.43.097 and 48.44.095 and WAC 284-07-050(2), to file annual statements in accordance with the NAIC Accounting Practices and Procedures Manual and Annual Statement Instructions. Below is an overview of the insufficiencies, errors, and inadequacies discovered during the examination:

a) Holding Company Disclosure

The Company did not disclose in the General Interrogatories of its 2002 NAIC Annual Statement that it was a member of an Insurance Holding Company System, as required by the NAIC Accounting Practices and Procedures Manual and Annual Statement Instructions. The Company is a member of a holding company system regulated pursuant to Chapter 48.31C RCW. Dental Health Services of America owns 100% of Dental Health Services, Inc. The Company properly submitted the necessary holding company filings pursuant to Chapter 48.31C RCW with the Washington State Office of the Insurance Commissioner.

b) Reclassification of Hospital/Medical Benefits to Claims Adjustment Expense

The Company incorrectly included \$147,662 of claims adjustment expense in the \$1,229,562 of hospital/medical benefits paid. Claim adjustment expenses represent costs associated with the processing of claims, which includes maintaining records, general clerical, office maintenance, rent, and utilities. In accordance with the Statements of Statutory Accounting Principles (SSAP) 55.6.C, these amounts should not be classified as hospital/medical benefits.

The Company is instructed to reclassify \$147,662 of expenses classified as "Hospital/Medical Benefits" to "Claims Adjustment Expense" for the year ended December 31, 2002. Additionally, the Company is instructed to make adequate provision for claims adjustment expense in future regulatory filings. **See Note #4.**

c) Unpaid Claims Adjustment Expense

The Company did not make a provision for unpaid claim adjustment expenses required to adjudicate the unpaid claims for the year ended December 31, 2002. This was also a finding in the December 31, 1990 examination. A provision must be made to account for a portion as "Unpaid Claims Adjustment Expense," in accordance with SSAP 55.8. This provision allows for management estimates of the ultimate costs of settling unpaid claims. Based on a request from the Company for assistance, the examination team applied the ratio of claims adjustment expense to healthcare expenses multiplied by claims unpaid. The product results in an estimate of unpaid claims adjustment expense needed to adjudicate unpaid claims. The Company is instructed to make provisions for \$2,115 of "Unpaid Claims Adjustment Expense" in accordance with SSAP 55.8 and for future filings. **See Note #2.**

d) Accident and Health Premiums Due and Unpaid/Health Care Receivables

The Company classified amounts due from policyholders as "Health Care Receivables" in the amount of \$19,731 on Page 2, Line 11 of the 2002 NAIC Annual Statement. The NAIC Annual Statement Instructions state that accident and health premiums due and unpaid include direct and group, billed and uncollected premiums, as opposed to Health Care Receivables, which are amounts due from others, such as subrogation. The Company is instructed to properly classify accident and health premiums due and unpaid in the amount of \$19,731 for the year ended December 31, 2002 in accordance with the NAIC Annual Statement Instructions. **See Note #3.**

e) Admitted Asset Disclosures

The Company did not properly list depreciation for EDP equipment on Page 14, Line 13 of the 2002 NAIC Annual Statement. The Company also did not disclose the method or methods used in computing depreciation with respect to major classes of depreciable assets. The Company is instructed to properly report depreciation in its 2002 NAIC Annual Statement for EDP equipment and to disclose the method or methods used in computing depreciation with respect to major classes of depreciable assets, in accordance with SSAP 16.5.

f) Electronic Data Processing Equipment and Software

The Company incorrectly classified electronic data processing (EDP) equipment as admitted assets, in violation of RCW 48.12.010(11). Specifically, the Company admitted EDP equipment valued below \$25,000, the minimum allowable amount a company may use in the determination of admitted assets. Additionally, the Company classified various office equipment, including furniture and fixtures, and other miscellaneous expenses in the balance of EDP equipment, which is not in accordance with SSAP 4, 16, 19 and RCW 48.12.020(5). The only remaining admitted asset after the examination adjustments is operating system software valued at \$236, net of depreciation. Also, the Company, in violation of RCW 48.05.280, provided fixed assets and depreciation schedules that did not match the general ledger detail. The Company is instructed to non-admit \$23,817 of EDP equipment and to properly classify admitted and non-admitted

assets and expenses for EDP equipment, in accordance with RCW 48.12.020(5) and RCW 48.12.010(11), respectively. **See Note #1.**

g) Money Market

The Company incorrectly included \$794,156 of money market funds in the reported cash balance of \$1,818,666 on the 2002 NAIC Annual Statement. SSAP 2.10 defines money markets as short term investments. As such, the amount reported should be reclassified to reflect the money market balance as short term investments for \$794,156, with the difference of \$1,024,510 reported as cash. The Company is instructed to separately report the cash and short term investment (money market funds) on the 2002 NAIC Annual Statement, Page 2, Line 5 and for future filings, in accordance with SSAP 2.10.

h) Exhibit 9 - Furniture, Equipment and Supplies Owned

The Company erroneously completed Exhibit 9, "Furniture, Equipment and Supplies Owned" on Page 24 of the 2002 NAIC Annual Statement for the year ended December 31, 2002. The Company reported \$27,067 in column 5, row 5, "Assets not Admitted." The amounts (based on unadjusted numbers) should have been properly allocated among the correct asset categories. Specifically, Exhibit 9 should have shown the following, unadjusted figures, in column 5: Line 1 – Administrative furniture and equipment for \$3,261; Line 2 – Medical furniture, equipment and fixtures for \$23,806; Line 55 – Other property and equipment for \$0. Furthermore, the amount reported in column 6, row 5, "Net Admitted Assets," is \$24,053. This amount should have been properly allocated among the correct asset categories. Specifically, Exhibit 9 should have shown the following, unadjusted figures, in column 6: Line 2 - \$1,918; Line 5 - \$22,135 (based on unadjusted numbers). The Company is instructed to properly complete Exhibit 9 for the 2002 NAIC Annual Statement and for future filings, in accordance with the NAIC Annual Statement Instructions.

2. Historical Reports/Limitations of Computer System

The Company could not provide several historical accounting reports as of a specific date. Although this did not materially affect the ability to examine the Company since other procedures were performed to satisfy the examination objectives, it does violate RCW 48.05.280. This statute requires full and adequate accounts and records of the Company's assets, obligations, transactions and affairs.

The Company is instructed to either update its software so that historical reports can be compiled from its database, or retain hard-copy reports as of year-end in accordance with RCW 48.05.280.

3. Inter-Company Agreements

In violation of RCW 48.31.C.040(2)(c)(v), the Company has not filed with the OIC its agreements between affiliates. The said statute requires the filing of "all management agreements, service contracts and cost-sharing arrangements" with the OIC.

The Company is instructed to comply with RCW 48.31.C.040(2)(c)(v) and file all inter-company agreements with the Washington State Office of Insurance Commissioner.

COMMENTS AND RECOMMENDATIONS

1. Disaster Recovery Plan

The Company does not have a written Disaster Recovery Plan. It is recommended that the Company write, test, and implement a Disaster Recovery Plan that includes appropriate escalation procedures to resolve operational failures in a timely manner, as promulgated by NAIC Guidelines.

2. Business Contingency Plan

The Company does not have a written Business Contingency Plan. It is recommended that the Company prepare a Business Contingency Plan that addresses the continuation of all significant business activities, including financial functions, telecommunication services and data processing services, in the event of a disruption of normal business activities, as required by NAIC Guidelines.

3. Claims Procedure Manual

The Company does not have a claims procedure manual. It is recommended that the Company create a procedure manual for the processing of claims and handling of claim inquiries.

HISTORY

The Company was registered as a health care service contractor in October 1984, and was changed to a limited health care service contractor in May 1991. Dental Health Services of California (a California Corporation established in May 1974, "DHS-CA") owned 100% of Dental Health Services, Inc., ("the Company") as of June 28, 1984. On April 17, 1986, Dental Health Services of America, Inc., ("DHS-AM") purchased 100% of the Company from DHS-CA. The Company is now wholly-owned by Dental Health Services of America.

The Company administers prepaid dental health care services in the state of Washington, which is also known as a capitated dental care plan. In a capitation plan, premiums are collected from individual and group policyholders. The policyholder selects a dentist from a list of providing dentists, who are members of the plan. A flat fee is paid monthly to the participating dentist ("capitation payment") for each policyholder that has selected the dentist as his or her provider. The policyholders receive services from their providing dentist for a set amount ("co-payment"). The co-payments vary depending on the type of services rendered, but are agreed upon between the Company, participating provider, and members.

MANAGEMENT AND CONTROL

Article 3, paragraph (a), of the Articles of Incorporation states the purpose of the Company is to establish market and administer prepaid dental health care service plans in the state of Washington and elsewhere.

Article 6 states that the Board of Directors will consist of Godfrey Pernell and Gary Pernell. Article 7 states that the Board of Directors has the power to adopt, amend, or repeal the Bylaws of the Company.

Board of Directors

The following Directors were elected to serve the Company as of December 31, 2002:

Godfrey Pernell	President
Gary Pernell	Secretary Treasurer

Officers

The principal officer of the Company is Godfrey Pernell, President. Mr. Pernell has been President of the Company since its inception. The following officers, who have each served for four years or longer, were elected to serve the Company as of December 31, 2002:

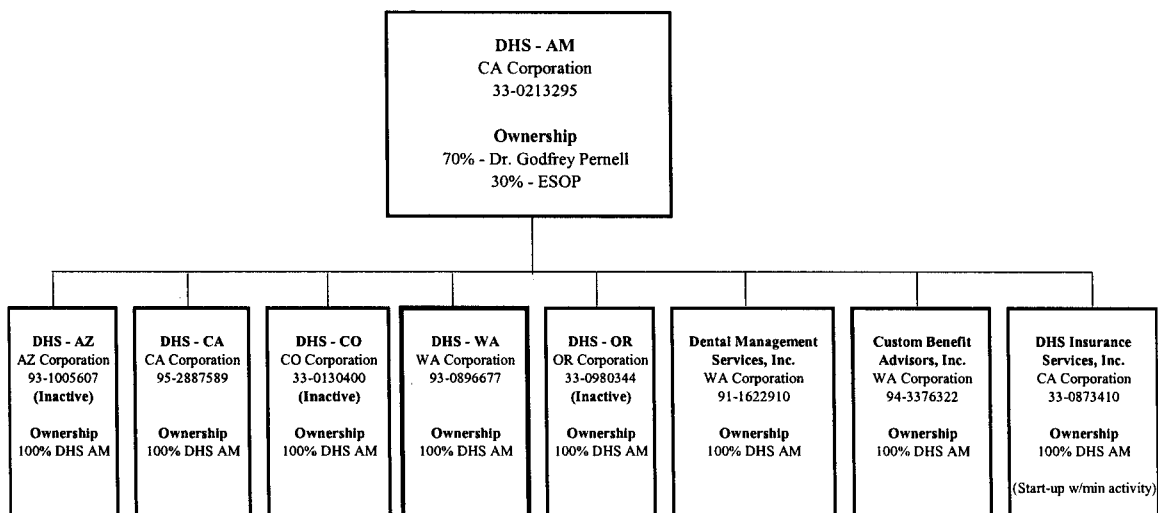
Godfrey Pernell	President
Gary Pernell	Secretary Treasurer
Mehdi Moussavi	Chief Financial Officer

AFFILIATED COMPANIES

The Company is a member of a holding company system regulated pursuant to Chapter 48.31C RCW. Dental Health Services of America owns 100% of Dental Health Services, Inc. Dental Health Services of America was established in February 1985 by Godfrey Pernell. A consolidated return is filed with the Internal Revenue Service for the Dental Health Services group of companies. Refund or payment of tax is allocated to affiliates based on an inter-company tax allocation agreement.

Claims administration, capitation processing and accounting services were provided for a fee to the Company by Dental Health Services of California which is wholly-owned by Dental Health Services of America.

HOLDING COMPANY ORGANIZATION CHART



"DHS - AM" - Dental Health Services of America, Inc.

"DHS - AZ" - Dental Health Services, Inc. (An Arizona Corporation)

"DHS - CA" - Dental Health Services

"DHS - CO" - Dental Health Services, Inc. (A Colorado Corporation)

"DHS - OR" - Dental Health Services, Inc. (An Oregon Corporation)

"DHS - WA" - Dental Health Services, Inc. (A Washington Corporation)

CORPORATE RECORDS

The examiners reviewed the corporate records of Dental Health Services, Inc., for the period under examination. All Board meetings were conducted with a quorum present. The Board members ratified all changes to the Articles of Incorporation and Bylaws.

INTERNAL SECURITY

Conflict of Interest

The Company requires all of its employees to sign an Employee Code of Conduct which contains a Conflict of Interest Statement.

Fidelity Bond and Other Insurance

The Company is the named insured on various insurance policies including property and general liability loss, workers' compensation and employers' liability, fidelity, errors and omissions, and directors and officers' liability coverage.

The Company's fidelity coverage of \$1,600,000 meets the suggested NAIC minimum coverage.

OFFICERS', EMPLOYEES', AND AGENTS' WELFARE AND PENSION PLANS

The Company offers its employees participation in the company-sponsored employee stock option plan (ESOP). The plan received a favorable determination from the Internal Revenue Service in September, 2002.

TERRITORY AND PLAN OF OPERATIONS

The Company is a domestic health care service contractor authorized to do business in state of Washington. The Company is considering the opportunity to become a foreign health care service contractor in the state of Oregon while domiciled in the state of Washington.

GROWTH OF COMPANY

The following schedules reflect the growth of the Company by year beginning in 1998. The amounts shown were compiled from the Company's filed NAIC Annual Statements (2002 amounts are net of examination adjustments):

Schedule 1

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital & Surplus</u>
2002	\$1,847,398	\$755,897	\$1,091,501
2001	1,502,945	664,507	838,438
2000	1,414,864	680,175	734,689
1999	774,512	467,520	306,992
1998	481,656	166,168	315,488

Schedule 2

<u>Year</u>	<u>Premiums Earned</u>	<u>Net Underwriting Deductions</u>	<u>Underwriting Gain or (Loss)</u>	<u>Investment & Other Income</u>	<u>Pre-Tax Income</u>
2002	\$3,082,505	\$2,817,412	\$265,090	\$29,261	\$294,352
2001	2,830,743	2,787,802	42,941	48,764	91,705
2000	2,429,463	2,049,064	380,399	43,250	423,649
1999	755,123	1,123,228	(368,105)	18,854	(349,251)
1998	268,546	664,279	(395,733)	52,756	(342,977)

REINSURANCE

The Company does not use reinsurance. Our examination team felt that this did not need further review due to the small size of the Company.

BUSINESS IN FORCE BY STATES

All business and contracts underwritten by the Company are in the state of Washington.

ACCOUNTING RECORDS AND PROCEDURES

The Company maintains its accounting records on a Generally Accepted Accounting Principles (GAAP) modified accrual basis of accounting and adjusts to Statutory Accounting Practices (SAP) basis for Annual Statement reporting.

The Annual Statements filed with the Washington State Office of Insurance Commissioner during the examination period were examined and reviewed to verify that they were prepared in a manner consistent with the statutory requirements of Title 48 Revised Code of Washington, Title 284 Washington Administrative Code, the standards and procedures required or prescribed by the Washington State Office of Insurance Commissioner and the National Association of Insurance Commissioners.

Inter-Company Agreements

The Company has several Inter-Company Agreements with its parent, Dental Health Services of America. One of which is a General Management Services Agreement dated November 1, 1999 where Dental Health Services of America provides services to the Company for a fee. There is also an Inter-Company Tax Allocation Agreement between the Company and Dental Health Services of America. The agreement is dated September 20, 2000.

In addition, the Company has a Service Agreement with Dental Health Services of California. The Agreement allows DHS-CA to provide claims administration, capitation processing and accounting services were provided to the Company for a fee.

EDP SYSTEMS AND OPERATIONS

The management of the Company is sufficiently knowledgeable of EDP issues and the CFO works with the IS Department to provide direction and oversight. Systems development, acquisition and maintenance controls were evaluated to gain assurance that programs and systems are designed, tested, approved and implemented using appropriate controls. The Company has detailed written documentation for its major operations and financially significant applications. There is proper supervision and review for each project to ensure satisfactory completion.

PRIOR EXAMINATION

A comprehensive examination of the Company's financial records was performed for the year ending December 31, 1990. A limited scope ("target") examination was performed for the year ending December 31, 1995.

FOLLOW-UP ON PREVIOUS EXAMINATION FINDINGS

The prior target examination report dated September 14, 1995, included the following recommendation:

1. Surplus Commitment

Prior Recommendation:

It was recommended that the OIC either (1) require the Company to obtain formal commitment from its parent company prior to writing new business, or (2) issue an Order of Rehabilitation pursuant to RCW 48.31.030(5).

Current Exam Findings/Instructions:

The parent company infused \$150,000 into DHS on September 1, 1995 and expressed its "commitment to support Dental Health Services, Inc.," in a letter dated September 5, 1995.

The prior examination report dated December 31, 1990, included the following recommendations:

1. General

Prior Exam Recommendation:

Because the Company's financial condition and its ability to continue were of extreme concern to the OIC, it was recommended that the Company report material changes in the Company's financial condition to the OIC.

Current Exam Findings/Instructions:

The Company has improved its financial condition and reported profits for the past three years: 2002, 2001, and 2000.

2. Unpaid Claim Adjustment Expense

Prior Exam Recommendation:

It was recommended that the Company develop a reserve methodology to determine the appropriate amount of unpaid claim adjustment expense, and to cease the classification of such expenses as administrative expenses.

Current Exam Findings/Instructions:

As of December 31, 2002, the Company had not implemented a reserve methodology for unpaid claims adjustment expense. The current examination

identified this as an instruction/reclassification, and the Company responded that it would properly reserve for unpaid claims adjustment expenses in the future. See **Instruction #1.C.**

3. Underwriting

Prior Exam Recommendation:

Because of unfavorable underwriting results, it was recommended that the Company review and monitor its underwriting practices to determine the appropriateness of the premiums charged and expenses anticipated for its contracts.

Current Exam Findings/Instructions:

The Company has reviewed and monitored its underwriting practices to determine the appropriateness of the premiums charged and expenses anticipated for its contracts since the previous exam and has shown profits for the three years ending 2002, 2001, and 2000.

4. Conflict of Interest Statements

Prior Exam Recommendation:

It was recommended that the Company implement a conflict of interest procedure to ensure that all directors, officers, and key employees fully complete or update conflict of interest statements, annually.

Current Exam Findings/Instructions:

The Company has implemented a Conflict of Interest Statement within its Code of Conduct Contract, and indicated that all employees are required to sign the contract.

5. Reinsurance

Prior Exam Recommendation:

Since the Company does not have a reinsurance program, it was recommended that the Company review the need for an adequate reinsurance program.

Current Exam Findings/Instructions:

The Company does not use reinsurance. Our examination team felt that this did not need further review due to the small size of the Company.

6. Inter-Company Agreements

Prior Exam Recommendation:

It was recommended that the Company formalize its inter-company loan policy for advances and federal tax allocations.

Current Exam Findings/Instructions:

Since the prior examination, the Company has formalized its inter-company loan policy for advances and federal tax allocations. However, the Company has not filed its inter-company agreements, as required by 48.31.C.040(2)(c)(v). See **Instruction #3**.

7. Unpaid Claims

Prior Exam Recommendation:

Because the Company misclassified its unpaid claims as other expenses due or accrued, it was recommended that the Company properly classify its unpaid claim reserves as unpaid claims. It was recommended further that the Company consider using some claims run out after year-end to develop its claims liabilities or reserves, accrue its periodontics, endodontics, and out of service area services as of when the treatment has been approved or the first date of compensable treatment, and classify these liabilities or reserves as unpaid claims.

Current Exam Findings/Instructions:

The Company's independent actuary was used to accrue and classify unpaid claims. This number was reviewed by the OIC's actuary and appeared reasonable.

8. Washington State Contract

Prior Exam Recommendation:

It was recommended that the Company update its contract with the Washington State Health Care Authority and resolve the benefit difference between the Company's contract and the PEBB booklet.

Current Exam Findings/Instructions:

The contract with the Washington State Health Care Authority was not renewed.

FINANCIAL STATEMENTS

The following examination financial statements show the financial condition of the Company as of December 31, 2002:

Statement of Assets, Liabilities, Capital, and Surplus

Statement of Revenue and Expenses

Analysis of Examination Changes affecting Surplus

Comparative Statement of Assets, Liabilities, Surplus and Other Funds

Comparative Underwriting and Investment Exhibit

Reconciliation of Surplus for the Period since the Last Examination

Dental Health Services
Statement of Assets , Liabilities, Capital, and Surplus
As of December 31, 2002

	Balance Per Company	Examination Adjustments	Balance Per Examination	Note No.
Assets				
Cash and short-term investments	\$ 1,818,666		\$ 1,818,666	
Subtotal, cash and invested assets	1,818,666		1,818,666	
Accident and health premiums due and unpaid	-	19,731	19,731	2
Health care receivables	19,731	(19,731)	-	2
Electronic data processing equipment and software	24,053	(23,817)	236	1
Total assets	\$ 1,862,450	\$ (23,817)	\$ 1,838,633	
Liabilities, Capital and Surplus				
Claims unpaid	\$ 15,500	\$ -	\$ 15,500	
Unpaid claims adjustment expenses	-	2,115	2,115	3
Premiums received in advance	569,071		569,071	
General expenses due or accrued	110,924	(2,115)	108,809	3
Federal and foreign income tax payable	2,102		2,102	
Amounts due to parents, subsidiaries and affiliates	58,300		58,300	
Total Liabilities	755,897	-	755,897	
Capital and surplus				
Common capital stock	10,000		10,000	
Gross paid-in and contributed surplus	1,518,442		1,518,442	
Aggregate write-ins for other than special surplus funds	(421,889)	(23,817)	(445,706)	1, 3
Total capital and surplus	1,106,553	(23,817)	1,082,736	
Total liabilities, capital and surplus	\$ 1,862,450	\$ (23,817)	\$ 1,838,633	

Dental Health Services
Statement of Revenue and Expenses
For the Year Ended December 31, 2002

	Balance Per Company	Examination Adjustments	Balance Per Examination	Note No.
Revenue				
Net premium Income	\$ 3,082,505		\$ 3,082,505	
Total Premiums	<u>3,082,505</u>		<u>3,082,505</u>	
Expenses				
Hospital/medical benefits	1,229,562	(147,662)	1,081,900	4
Claims adjustment expense	-	147,662	147,662	4
General administrative expenses	1,587,853		1,587,853	
Total Expenses	<u>2,817,415</u>	<u>-</u>	<u>2,817,415</u>	
Net gain or (loss)	<u>265,090</u>		<u>265,090</u>	
Net Investment income earned	28,996		28,996	
Net realized capital gains or (losses)	-		-	
Net Investment gains or (losses)	<u>28,996</u>		<u>28,996</u>	
Aggregate write-ins for other income expenses	265		265	
Net income or (loss) before federal income taxes	294,351		294,351	
Federal income taxes incurred	91,300		91,300	
Net Income (loss)	<u>\$ 203,051</u>		<u>\$ 203,051</u>	
Capital and Surplus Account				
Capital and surplus prior reporting year	\$ 838,438	\$ -	\$ 838,438	
Gains and Losses to Capital and Surplus				
Net Income or (loss)	203,051	-	203,051	
Change in nonadmitted assets	65,065	(23,817)	41,248	1, 3
Net Change in capital and Surplus	<u>268,116</u>	<u>(23,817)</u>	<u>244,299</u>	
Capital and Surplus end of reporting year	<u>\$ 1,106,553</u>	<u>\$ (23,817)</u>	<u>\$ 1,082,736</u>	

Dental Health Services
Analysis of Examination Changes affecting Surplus
December 31, 2002

	<u>Increase/ (Decrease)</u>	<u>Note No.</u>	<u>Balance Per Examination</u>
Surplus, per Company			\$ 1,106,553
Assets			
Electronic data processing equipment and software	(23,817)	1	
Health care receivables	(19,731)	2	
Accident and health premiums due and unpaid	<u>19,731</u>	2	
	\$ (23,817)		
Liabilities			
Unpaid claims adjustment expense	(2,115)	3	
General Expenses due or accrued	<u>2,115</u>	3	
	\$ -		
Net increase/(decrease) to surplus			<u>(23,817)</u>
Surplus, per Examination			<u><u>\$ 1,082,736</u></u>

Dental Health Services
Comparative Statement of Assets , Liabilities, Capital, and Surplus
As of December 31, 2002

	2002*	2001
Assets		
Cash and short-term investments	\$ 1,818,666	\$ 1,458,492
Subtotal, cash and invested assets	\$ 1,818,666	\$ 1,458,492
Accident and health premiums due and unpaid	19,731	-
Health care receivables	-	16,755
Electronic data processing equipment and software	236	27,698
Total assets	\$ 1,838,633	\$ 1,502,945
Liabilities, Capital, and Surplus		
Claims unpaid	\$ 15,500	\$ 16,500
Unpaid claims adjustment expenses	2,115	-
Premiums received in advance	569,071	552,841
General expenses due or accrued	108,809	95,064
Federal and foreign income tax payable and interest thereon	2,102	102
Amounts due to parents, subsidiaries and affiliates	58,300	-
Total Liabilities	755,897	664,507
Common capital stock	10,000	10,000
Preferred capital stock	-	-
Gross paid in and contributed surplus	1,518,442	1,518,442
Surplus notes	-	-
Aggregate write-ins for other than special surplus funds	(445,706)	(690,004)
Total capital and surplus	1,082,736	838,438
Total liabilities, capital and surplus	\$ 1,838,633	\$ 1,502,945

*Adjusted amounts per Examination

Dental Health Services
Comparative Statement of Revenue and Expenses
For the Year Ended December 31, 2002

	2002*	2001
Member months	242,984	240,689
Net premium Income	\$ 3,082,505	\$ 2,830,743
Total Revenues	3,082,505	2,830,743
Medical and Hospital:		
Hospital/medical benefits	1,081,900	1,001,911
Subtotal	1,081,900	1,001,911
Total Medical and Hospital (less reinsurance recoveries)	1,081,900	1,001,911
Claims adjustment expense	147,662	-
General administrative expenses	1,587,853	1,785,891
Total underwriting deductions	2,817,415	2,787,802
Net Underwriting gain or (loss)	265,090	42,941
Net Investment income earned	28,996	47,883
Net realized capital gains or (losses)	-	-
Net Investment gains or (losses)	28,996	47,883
Net gain or (loss) from agents' or premium balances charged off	-	-
Aggregate write-ins for other income expenses	265	881
Net income or (loss) before federal income taxes	294,351	91,705
Federal income taxes incurred	91,300	(31,000)
Net Income (loss)	\$ 203,052	\$ 122,705
Capital and Surplus Account		
Capital and surplus prior reporting year	\$ 838,438	734689
GAINS AND LOSSES TO CAPITAL AND SURPLUS		
Net Income or (loss)	203,052	122,705
Change in nonadmitted assets	41,248	-18956
Net Change in capital and Surplus	244,300	103,749
Capital and Surplus end of reporting year	\$ 1,082,737	\$ 838,438

*Adjusted amounts per the Examination

Dental Health Services
Reconciliation of Surplus for the Period Since the last Examination
December 31, 2002

	2002*	2001	2000	1999	1998	1997
Capital and Surplus						
Capital and Surplus prior reporting year	\$ 838,438	\$ 734,689	\$ 306,992	\$ 315,485	\$ 131,246	\$ 156,459
Gains and Losses to Capital & Surplus						
Net Income or (loss)	203,052	122,705	465,649	(273,596)	(325,928)	(144,466)
Change in nonadmitted assets	41,246	(18,956)	(67,952)	(1,897)	13,728	(747)
Change in surplus notes					(575,000)	120,000
Aggregate write-ins for gains or (losses) in surplus			30,000	267,000	1,071,442	
Net change in capital and surplus	244,298	103,749	427,697	(8,493)	184,242	(25,213)
Capital and surplus end of reporting year	\$ 1,082,736	\$ 838,438	\$ 734,689	\$ 306,992	\$ 315,485	\$ 131,246

*Adjusted amounts per the Examination

Notes to the Financial Statements

1) Admitted/Non-Admitted Assets

The Company incorrectly classified electronic data processing (EDP) equipment as admitted assets, in violation of RCW 48.12.010(11). Specifically, the Company admitted EDP equipment valued below \$25,000, the minimum allowable amount a company may use in the determination of admitted assets. Additionally, the Company classified various office equipment, including furniture and fixtures, and other miscellaneous expenses in the balance of EDP equipment, which is not in accordance with SSAP 4, 16, 19 and RCW 48.12.020(5). The only remaining admitted asset after the examination adjustments is operating system software valued at \$236, net of depreciation. Also, the Company, in violation of RCW 48.05.280, provided fixed assets and depreciation schedules that did not match the general ledger detail. The Company is instructed to non-admit \$23,817 of EDP equipment and to properly classify admitted and non-admitted assets and expenses for EDP equipment, in accordance with RCW 48.12.020(5) and RCW 48.12.010(11), respectively.

2) Unpaid Claims Adjustment Expense

The Company did not make a provision for unpaid claim adjustment expenses required to adjudicate the unpaid claims for the year ended December 31, 2002. This was also a finding in the December 31, 1990 examination. A provision must be made to account for a portion as "Unpaid Claims Adjustment Expense," in accordance with SSAP 55.8. This provision allows for management estimates of the ultimate costs of settling unpaid claims. Based on a request from the Company for assistance, the examination team applied the ratio of claims adjustment expense to healthcare expenses multiplied by claims unpaid. The product results in an estimate of unpaid claims adjustment expense needed to adjudicate unpaid claims. The Company is instructed to make provisions for \$2,115 of "Unpaid Claims Adjustment Expense" in accordance with SSAP 55.8 and for future filings.

3) Accident and Health Premiums Due and Unpaid/Health Care Receivables

The Company classified amounts due from policyholders as "Health Care Receivables" in the amount of \$19,731 on Page 2, Line 11 of the 2002 NAIC Annual Statement. The NAIC Annual Statement Instructions state that accident and health premiums due and unpaid include direct and group, billed and uncollected premiums, as opposed to Health Care Receivables, which are amounts due from others, such as subrogation. The Company is instructed to properly classify accident and health premiums due and unpaid in the amount of \$19,731 for the year ended December 31, 2002 in accordance with the NAIC Annual Statement Instructions.

4) Reclassification of Hospital/Medical Benefits to Claims Adjustment Expense

The Company incorrectly included \$147,662 of claims adjustment expense in the \$1,229,562 of hospital/medical benefits paid. Claim adjustment expenses represent costs associated with the processing of claims, which includes maintaining records,

general clerical, office maintenance, rent, and utilities. In accordance with the Statements of Statutory Accounting Principles (SSAP) 55.6.C, these amounts should not be classified as hospital/medical benefits.

The Company is instructed to reclassify \$147,662 of expenses classified as "Hospital/Medical Benefits" to "Claims Adjustment Expense" for the year ended December 31, 2002. Additionally, the Company is instructed to make adequate provision for claims adjustment expense in future regulatory filings.

ACKNOWLEDGMENT

Acknowledgment is hereby made of Mehdi Moussavi, CFO, as well as other members of the staff of Dental Health Services, Inc., for the cooperation extended to the examiners during the course of this examination.

In addition to the undersigned, John R. Jacobson, AFE; Charles J. Mitchell, CPA; Lichiou Lee, ASA, MAAA, Health Actuary; and Adrienne C. DeBella, all from the Washington State Office of Insurance Commissioner, participated in the examination and the preparation of this report.

Respectfully submitted,

A handwritten signature in cursive script that reads "Mike Bosley". The signature is written in dark ink and is positioned above the printed name.

Mike Bosley
Examiner-in-Charge
State of Washington

AFFIDAVIT

STATE OF WASHINGTON

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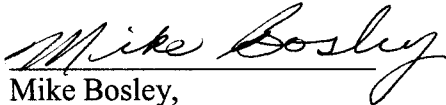
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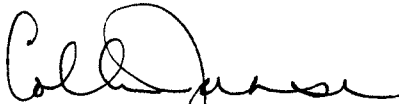
Mike Bosley, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

He attests that the examination of Dental Health Services, Inc., was performed in a manner consistent with the standards and procedures required or prescribed by the Washington State Office of Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).



Mike Bosley,
Examiner-in-Charge
State of Washington

Subscribed and sworn to before me this 26th day of May, 2004.



Notary Public in and for the
State of Washington

